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SUBJECT: 2010 INVESTMENT CLIMATE STATEMENT

REF: 09 STATE 124006

¶1. (U) In response to reftel, please find following the submission of the 2010 Investment Climate Statement for Venezuela.

¶2. (U) Openness to Foreign Investment

Economic and political uncertainties, a recent history of actual and threatened nationalizations, and increasing state intervention in the economy, make Venezuela's investment climate considerably less welcoming than its relatively liberal legal framework would otherwise suggest. As a result of these risks, foreign direct investment in Venezuela has been lower in recent years than in most other Latin American countries. In 2008, despite these challenges, many companies with investments in Venezuela recorded strong profits thanks to five consecutive years of high economic growth fueled by record oil prices and massive government spending. In 2009, the investment climate was less favorable given increasing political and economic uncertainty and the decline in oil prices, although many companies decided to maintain their investment position in Venezuela in the expectation that the economic environment will eventually improve. Strict labor laws and the devaluation of dividends and payments to suppliers have also increased the costs of withdrawing from the Venezuelan market. In 2010, Venezuela's economic outlook is continued recession or anemic growth.

Important developments in 2009 and early 2010 included the devaluation of the official exchange rate, a series of banking interventions, an electricity crisis that caused rolling outages throughout the country, and the nationalization of assets in the petroleum, steel, tourism, agribusiness, and banking industries. The Government of the Bolivarian Republic of Venezuela (GBRV) has also revoked or refused to renew important concessions held by private companies.

In August 2007, as part of his push toward "21st Century Socialism," President Chavez proposed a series of constitutional reforms that would have, among other things, defined Venezuela as a socialist state and significantly weakened protections for private property. Voters rejected these proposals by a slim margin in a

December 2007 referendum, but President Chavez decreed 26 new laws on July 31, 2008, that implemented some of the rejected constitutional reforms and weakened property rights. Notably, the Law of Agro-Food Security and Sovereignty increased state power over food distribution, while an amendment to Venezuela's consumer protection law eliminated the need for a previous declaration of public utility by the National Assembly before the executive can start expropriation procedures. Both laws permit the GBRV to seize goods or property in the interest of the larger community. In 2009, in a new threat to property rights, the GBRV published an Urban Lands Law that empowered the state to seize "underutilized urban land" and designated over 1000 properties in Caracas "of cultural interest," placing restrictions on their transfer and modification.

Growing state intervention in the economy has created a series of distortions. The GBRV has maintained a fixed exchange rate and exchange controls since February 2003. In January 2010, President Chavez announced a devaluation of the bolivar, but the official bolivar/dollar exchange rate remains overvalued. As a result, there is intense competition to gain access to hard currency at the official rate (including for repatriation of capital and/or profits), and rationing of official dollars has led to the development of a parallel foreign exchange market. The GBRV also maintains price controls on a wide variety of goods and services. These controls have caused shortages and have created disincentives to investment, in some cases driving companies that produce price-controlled goods out of business.

In 2009, Venezuela ranked 174th in the Heritage Foundation's Index of Economic Freedom, reflecting substantial declines in eight of ten economic freedoms since last year. According to the Heritage Foundation report, Venezuela had the second lowest score in Latin America due to an increasingly interventionist government, inefficient and rigid regulation, opaque and burdensome investment laws, corruption in civil society and the judiciary, and the weakening of property rights. The World Bank's 2010 "Doing Business Report" ranked Venezuela 177th in terms of the ease of doing business, with an average of 141 days and 16 procedures necessary to start a business. Transparency International's 2009 Corruption Perceptions Index ranked Venezuela as the second most corrupt country in Latin America.

Measure	Year	Index/Ranking
TI Corruption Index	2009	162
Heritage Economic Freedom	2009	174
World Bank Doing Business	2010	177

Legal Framework for Foreign Investment

In theory, Venezuela's legal framework for foreign investment is relatively liberal: the law requires equal treatment for both foreign and local companies, with the notable exception of a few sectors in which the state or Venezuelan nationals must be majority owners, including hydrocarbons and the media. Repatriation of capital and dividends is allowed, subject to the exchange control regime. In practice, the Venezuelan judicial system is highly politicized.

The 1999 Constitution

The Venezuelan Constitution of 1999 treats capital investment as a means of promoting the development of the national economy. Article 301 of the Constitution adopted international standards for the treatment of private capital, with equal treatment of local and foreign capital. The Constitution reserves strategic sectors such as oil and hydropower for the State.

Decree 2095

Decree 2095 of 1992 established the legal framework for foreign investment in Venezuela. This decree implemented Andean Community Decisions 291 and 292 and lifted most prior restrictions on foreign participation in the economy. (Venezuela withdrew from the Andean Community in April 2006, but the GBRV has continued to apply some of the Andean Community norms in the absence of any other regulations.) Article 13 of the decree explicitly guaranteed foreign investors the same rights and imposed the same obligations as applied to national investors "except as provided for in special laws and limitations contained in this Decree." Decree 2095 also guaranteed foreign investors the right to repatriate 100 percent of profits and capital, including proceeds from the sale of shares or liquidation of a company, and allowed for unrestricted reinvestment of profits.

Under Decree 2095, foreign investors need only to register with the Superintendent of Foreign Investment (SIEX) within 60 days of the date a new investment is made. Foreign companies may generally open offices in Venezuela without prior authorization from SIEX as long as they do not engage in certain sales or business activities that would require registration. No prior authorization is required for technical assistance, transfer of technology, or trademark-use agreements, provided they are not contrary to existing legal provisions.

Decree 2095 reserved three areas of economic activity to "national companies": (1) broadcast media, (2) Spanish-language newspapers, and (3) professional services that are regulated by national laws. These services include law, architecture, engineering, medicine, veterinary medicine, dentistry, economics, public accounting, psychology, pharmacy, and management. A "national company" (as defined in Article 1 of Andean Community Decision 291) is a company in which Venezuelan nationals hold more than 80 percent of the equity. Foreign capital is therefore restricted to a maximum of 19.9 percent in the areas noted above. The Investment Promotion and Protection Law of October 1999, whose regulations were published in July 2002, maintained the same reserved sectors.

Foreign professionals are free to work in Venezuela without restriction-provided that they possess a government-issued identity card or government-approved work permit-but must first revalidate their certification at a Venezuelan university. Consulting

services under contract for a specific project are not subject to this requirement.

The Hydrocarbons Sector

A number of sectors are regulated by "special laws" that supplement the Constitution and affect the business environment. These sectors include hydrocarbons, mining, telecommunications, banking, and insurance. Of these, the hydrocarbons sector has the most significant restrictions on foreign investment.

Over the last several years the GBRV has made a number of changes in royalty, tax policies, and contracts that have substantially increased uncertainty for foreign companies operating in Venezuela. For example, the 2001 Hydrocarbons Law did not expressly grandfather contracts executed under earlier legislation. Specifically, it did not include the 33 operating service contracts awarded for "marginal" or inactive oilfields in three rounds in the 1990s, exploration and production profit-sharing agreements awarded in 1996, and four so-called "Strategic Associations," legal entities with majority private and minority PDVSA ownership formed in the 1990s to extract and upgrade Venezuela's extra heavy oil in the Faja region. The GBRV argued in 2001 that no grandfather provision was necessary because retroactive application of legislative provisions is forbidden by constitutional mandate.

In contrast to the legal framework for petroleum, the 1999 Gaseous Hydrocarbons Law offers more liberal terms to investors in the unassociated natural gas sector. This law opened the entire natural gas sector to private investment, both domestic and foreign, and created a licensing system for exploration and production regulated by the Ministry of Energy and Mines (now the Ministry of Energy and Petroleum). The state retained ownership of all natural gas "in situ", but PDVSA involvement was not required for gas development projects. Complete vertical integration of the gas business from wellhead to consumer was prohibited. President Chavez has publicly stated, however, that he would like to modify the terms of the 1999 law, i.e. to require that the state have a controlling interest in primary unassociated natural gas activities.

The 2001 Hydrocarbons Law reserved the rights of exploration, production, "gathering," and initial transportation and storage of petroleum and associated natural gas for the state. Under this regime, primary activities must be carried out directly by the state, by a 100 percent state-owned company such as Petroleos de Venezuela (PDVSA), or by a joint venture company with more than 50 percent of the shares held by the state. The law left refining ventures open to private investment as well as commercialization activities, under a license and permit regime. It also stipulated that any arbitration proceedings would henceforth be in domestic not international venues.

In October 2004, the GBRV unilaterally eliminated a nine-year royalty holiday ceded to the Strategic Associations, arguing that this was allowable under earlier hydrocarbons legislation. The GBRV then informed companies with operating service contracts in early 2005 that they must migrate the contracts to joint ventures that conform to the 2001 Hydrocarbons Law. It threatened to seize fields operating under the services contracts on December 31, 2005 if oil companies did not sign transition agreements to migrate their contracts. Sixteen oil companies signed memorandums of understanding converting their contracts to joint ventures on March 31, 2005. In January 2008, ENI and Total, two companies that did not sign MOUs in 2005, reached an agreement with PDVSA.

President Chavez issued a decree in late February 2007 requiring the four Strategic Associations to convert to joint ventures in which PDVSA would hold a 60 percent stake. The decree established an April 30, 2007 deadline for completing the conversion. ConocoPhillips and ExxonMobil refused to migrate their investment stakes in three of the four associations. As a result, the GBRV took control of their investments. Both companies have treated the government's actions as expropriations and filed international arbitration claims against the GBRV.

In April 2008, a new windfall profit law was promulgated, mandating a special contribution by parties that export or transport natural or upgraded liquid hydrocarbons abroad. The contribution is calculated at a variable rate, which is determined using a formula involving the current price of oil and total exports from Venezuela.

On September 18, 2008, an Organic Law on the Restructuring of the Internal Liquid Fuels Market came into effect. The law mandated government control of domestic transportation and wholesale of liquid fuels and set a 60 day period for negotiations with the affected companies. The law does not define the term "liquid fuels" which created uncertainty as to whether it will apply to products other than gasoline and diesel fuel, such as motor oils or lubricants. This law affected several foreign companies which had investments in the downstream sector.

On May 7, 2009 Venezuela enacted the Organic Law that Reserves to the State the Assets and Services related to Hydrocarbon Primary Activities. The bill specifically affected petroleum service companies involved in the injection of water, steam, or gas as secondary recovery methods, as well as services rendered for the performance of primary activities on Lake Maracaibo. It provided for the "extinction" of contracts executed in the past between PDVSA and private companies. It stipulated that all contracts and activities governed by the law would be subject to Venezuelan law and subject to the exclusive jurisdiction of Venezuelan Courts. Under the provisions of this law, over 75 companies, including three U.S. firms, were expropriated by the GBRV.

On July 10, 2009, Venezuela's Organic Law for the Development of Petrochemical Activities entered into force. The new Petrochemicals Law has a limited scope of application and does not apply to activities regulated by the 2001 Hydrocarbons Law or the 1999 Gaseous Hydrocarbons Law. The Petrochemicals Law reserves basic and intermediate petrochemical activities for the State, as well as the assets and facilities required for their handling. It allows the State, through MENPET, to create mixed companies in which the GBRV will control at least 50 percent of the shareholder equity and exercise effective control over company decisions. The legislation mandates that certain investment incentives for the GBRV (e.g. technology transfer, incentives for industrial development, infrastructure supply, facility maintenance, social resources, import substitution, price advantages, and estimated profits) will be required for authorization of a mixed company. The Petrochemicals Law gives priority to the supply of the domestic market and the development of state and socialist companies. Upon expiration of the term of a mixed company, its works, ancillary facilities, and equipment shall be delivered to the State, free of encumbrance and without any indemnity whatsoever.

¶3. (U) Conversion and Transfer Policies

Foreign investors in capital markets and foreign direct investment projects are guaranteed the right to repatriate dividends and capital under the Constitution and Decree 2095. In practice, however, repatriation poses problems for many companies.

The Law Governing the Foreign Exchange System (Gazette No. 4897 of 1995) permits the executive branch to intervene in the foreign exchange market "when national interests so dictate." President Chavez used this law to create the Commission for the Administration of Foreign Exchange (CADIVI) on February 5, 2003 to regulate the purchase and sale of foreign currency. A Foreign Exchange Crime Law (Gazette No. 38,272 of 2005; revised by the National Assembly in December 2007) established criminal penalties and fines for transactions made outside the official foreign exchange process. The exemption for bond operations in this law has led to the creation of a parallel foreign exchange market, known as the "permuta" (swap) market, which is essentially a currency exchange market that operates through bond swaps. In early 2008, the GBRV prohibited the publication in Venezuela of the parallel exchange rate. In January 2010, President Chavez announced that the Central Bank of Venezuela (BCV) and the executive branch would intervene in the parallel foreign exchange market to "eliminate the speculative increase in hard currency."

In March 2005, the official exchange rate was fixed at 2,150 bolivars (Bs) per USD. (On January 1, 2008, the government introduced a redenominated bolivar known as the "bolivar fuerte" and adjusted the official rate to 2.15 bolivars per USD.) On

January 11, 2010, the GBRV devalued the bolivar and established two exchange rates, an official rate at 2.6 Bs/USD (which applies to certain priority imports) and a "petroleum dollar" rate at 4.3 Bs/USD (which applies to non-priority imports and most other categories of foreign exchange requests).

According to President Chavez's announcement on January 8, 2010, the official exchange rate will apply to imports of food, health products, machines and equipment, and science and technology; to imports made by the public sector; to remittances to family members; to hard currency for students studying abroad; to embassies and consulates in Venezuela, to retired pensioners; and in other special cases. The petroleum dollar rate will apply to "everything else," including the repatriation of dividends. Despite the devaluation, the official exchange rate remains overvalued, and companies that manufacture tradable goods in Venezuela find it very difficult to compete against goods imported at the official rate. The parallel market is relatively shallow and volatile: it closed around 6 Bs/USD at the end of 2009.

Foreign companies wishing to repatriate capital, dividends, or profits at the petroleum dollar rate have to secure authorization from CADIVI. CADIVI authorized approximately USD 579 million in repatriations in the first three quarters of 2009, down from 1.17 billion in 2008. However, many companies did not receive the full authorization they requested from CADIVI or received it after significant delays. Most companies have not had repatriations approved at the official rate for dividends after the 2006 fiscal year. Some companies have therefore turned to the parallel market for repatriation.

¶4. (U) Expropriation and Compensation

The government has nationalized significant assets in recent years. Given President Chavez's public threats to various sectors, this

trend is expected to continue. In January 2007, President Chavez announced his intent to nationalize strategic sectors. Shortly thereafter, the GBRV took over an electric company and cable company owned by US companies and investors. In 2008, the GBRV announced nationalizations of multi-national cement companies, a steel maker (SIDOR) and the Banco de Venezuela. In 2009, the GBRV nationalized assets in the petroleum, tourism, agribusiness, and banking industries. As noted above, ConocoPhillips and ExxonMobil have not come to agreement with the GBRV for the expropriation of their respective investments in the Strategic Associations and have filed for international arbitration. The Swiss cement supply company Holcim has also opened international arbitration proceedings following the nationalization of its assets in Venezuela. Oil service companies with expropriated assets are also considering filing for international arbitration.

Venezuela's 2001 land law, as modified in 2005, calls for the redistribution of "unproductive" land. The GBRV claims to have seized over 4.7 million acres of land since 1998. Some of this land was expropriated without compensation. These actions have discouraged investment in several key agricultural subsectors and reduced their output potential. The GBRV has also conducted inspections of plants to determine if they are in violation of Venezuelan law. These inspections have also led to occupation or nationalization. In March 2009, the GBRV expropriated a rice plant after claiming that the company was in violation of Venezuelan law for producing parboiled rice instead of government-regulated white rice.

On February 21, 2007, the GBRV published the "Decree Law of Popular Defense against hoarding, speculation, boycott, and any other conduct that affects consumption of food or products under price controls." The law defines all stages of the production cycle for regulated foods as within the ambit of "public utility and the social interest." It also empowers the government to expropriate any business that fits this sweeping definition in order to protect "food security and sovereignty." The GBRV invoked this decree to direct the military to seize two slaughterhouses in 2007.

¶5. (U) Dispute Settlement

Venezuela's legal system is available to foreign entities seeking to resolve investment disputes, and legal proceedings have generally not discriminated against foreign entities. However, the legal system is often slow and inefficient, and it has been accused of being both corrupt and lacking independence from the executive branch.

Decree 2095 allows for the arbitration of disputes as "provided by domestic law." The Commercial Arbitration Law (Gazette No. 36,430 of 1998) eliminated the previous requirement for judicial approval of arbitration; arbitration agreements involving national or international firms can therefore be automatically binding. The law also allows state enterprises to subject themselves to arbitration in contracts with private commercial entities, but requires that they first obtain the approval of the "competent statutory body," as well as the "written authorization" of the responsible minister. As noted above, however, the 2001 Hydrocarbons Law prohibits PDVSA from entering into agreements providing for international arbitration.

In a few cases, the GBRV has accepted the results of international arbitration in disputes involving foreign investors and government entities. Recent GBRV statements and actions, however, call into question whether this trend will continue. For example, in a

February 2006 decision involving Haagen-Dazs, GBRV courts invalidated an American Arbitration Association award entered in Miami. In April 2006, a GBRV court set aside an International Court of Arbitration award entered in favor of an Italian electronics company against VTV, the state owned television channel, in connection with a concession agreement.

In October 2008, the Venezuelan Supreme Court, while acknowledging the existence of a fundamental right to arbitration, resolved that the GBRV must expressly consent to it. The ruling challenged the legal analysis cited by a number of former investors who believe that Article 22 of the 1999 Law on Promotion and Protection of Investors provides them with access to arbitration with the World Bank International Centre for Investment Disputes (ICSID). The Court reasoned that Article 22 does not provide a clear and open offer of consent to ICSID arbitration. The impact of this decision remains to be seen.

¶6. (U) Performance Requirements and Incentives

Foreign companies receive the same tax treatment as domestic companies with the exception of the non-associated natural gas sector, where foreign investors receive preferential tax treatment. Performance requirements related to workforce composition are discussed in the labor section below. The state oil company, PDVSA, seeks to maximize local content and hiring in its negotiations with foreign companies. It also requires companies to make social contributions.

¶7. (U) Right to Private Ownership and Establishment

There are no legal limits on foreign ownership, except as noted in the Constitution, Decree 2095, and "special laws" (see above).

¶8. (U) Protection of Property Rights

Real Property Rights

Foreign investors may pursue property claims through Venezuela's legal system. See also the Expropriation and Compensation section for discussion of expropriation of real property rights and the Dispute Settlement section for a discussion of the legal system.

Intellectual Property Rights

Article 98 of the 1999 constitution guarantees state protection for intellectual property rights "in accordance with the conditions and exception established by law and the international treaties executed and ratified by the Republic in this field." Under the 1999 constitution, intellectual property rights are classified as cultural and educational rights rather than economic rights, as they were in the past. Venezuela is a signatory to the Berne Convention for the Protection of Literary and Artistic Works, the Geneva Phonograms Convention, the Universal Copyright Convention, and the Paris Convention for the Protection of Industrial Property. Although Venezuela is a member of the World Intellectual Property Organization (WIPO), no official GBRV delegation has attended a WIPO meeting in the last five years. In the past, Venezuela has implemented its obligations under the WTO Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS)

through Andean Community Decision 486.

The Venezuelan Industrial Property Office or SAPI, through its actions and occasional public antagonism towards IPR, often draws criticism from IPR advocates and rights holders. IPR protection is also hindered by the lack of adequate resources for the Venezuelan copyright and trademark enforcement police (COMANPI) and for the special IPR prosecutor's office. SAPI has publicly advocated for anti-IPR legislation and has not issued a pharmaceutical patent since 2004. Both President Chavez and Commerce Minister Eduardo Saman have publicly called for the elimination of patents. In 2009, the GBRV nullified two patents for an antibiotic produced by a pharmaceutical company after the company protested the local production of two generic copies of the drug. Pirated software, music, and movies are readily available throughout the country. In the 2009 Special 301 Annual Review, Venezuela remained on the "Priority Watch List."

Patents and Trademarks

Venezuela has provided the legal framework for patent and trademark protection through Andean Community Decision 486 (and Decision 345 for plant varieties). In September 2008, however, SAPI issued a press release resurrecting the Industrial Property Law of 1955, which expressly prohibited patent protection for pharmaceuticals and other products. The return to the 1955 law codifies the GBRV's de facto policy of refusal to issue patents, particularly in the area of medicines. The GBRV has not awarded a patent for new pharmaceuticals since 2004. Since 2002, Venezuela's food and drug regulatory agency has approved the commercialization of generic drugs without requiring unique test data. These drugs are the

bioequivalent of innovative drugs that have already received market approval. This practice thereby denies the innovative drug companies protection against unfair use of their test data as required by TRIPS. From a trademark standpoint, the 1955 Law changes the registration procedure and adds the cumbersome and expensive requirement of publishing trademark applications in a local newspaper before they can be published in the Industrial Property Bulletin. The Law also contains numerous provisions which conflict with TRIPS.

Venezuela does not automatically recognize foreign patents, trademarks or logotypes, so foreign investors must be sure to register patents and trademarks appropriately and in as many categories as are applicable. It is advisable not to have agents or distributors do so because the agent can then claim that he/she is the registered owner of the trademark in question. Following the nationalization of a well-known domestic coffee company in 2009, the GBRV expropriated the trademark and brand. Venezuelan authorities have indicated that a new industrial property law is a priority and, in fact, there is at least one draft which began circulating during the last quarter of 2009. SAPI's web page also mentions a new law and invites input; however, the page does not contain the text of any draft law which could be used as the basis for comments.

Copyrights

Andean Community Decision 351 and Venezuela's 1993 Copyright Law provide the legal framework for the protection of copyrights. The 1993 Copyright Law is modern and comprehensive and extends copyright protection to all creative works, including computer software. A National Copyright Office was established in October 1995 and given responsibility for registering copyrights, as well as for controlling, overseeing and ensuring compliance with the

rights of authors and other copyright holders.

COMANPI, the Venezuelan copyright and trademark enforcement branch of the police, fails to provide adequate copyright enforcement. Due to its lack of personnel, limited budget, and inadequate storage facilities for seized goods, COMANPI has had to work with the National Guard and private industry to enforce copyright laws. COMANPI can only act based on a complaint by a copyright holder; it cannot carry out an arrest or seizure on its own initiative. In the past, the GBRV's tax authority (SENIAT) has been more successful enforcing IPR laws. It has taken action against some businesses importing or selling pirated goods on the basis of presumed tax evasion; however, such actions on the part of SENIAT have decreased considerably over the past two years.

Since 2004, the National Assembly has also been considering a Copyrights bill. The bill, which was proposed by SAPI, has been very controversial and raised serious concerns in the private sector. Among other things, the bill calls for the local registration of all works, certification by a government-appointed commission to approve the copyright, a significant increase in royalty rates, and a provision to expropriate works if in the national interest.

¶9. (U) Transparency of Regulatory System

The Government of Venezuela adopted three laws in the early 1990's to promote free market competition and prevent unfair trade practices: a Law to Promote and Protect Free Competition (Gazette No. 34,880 of 1992), an Antidumping Decree (Gazette No. 4441 of 1992), and a Consumer Protection Law (Gazette No. 4898 of 1995).

In 1997 the government created a new agency, Pro Competencia, to implement the 1992 law. A government procurement law of 2001 supposedly increased transparency in the competitive bidding process for contracts offered by the central government, national universities, and autonomous state and municipal institutions.

Despite this legal and institutional framework, there is little transparency in Venezuela's regulatory system. The vast majority of contracts are awarded without open competition. There is often little coordination between the government and private sector, and even among different government agencies, in the process of promulgating new laws. As a result of this lack of coordination and the state's increasing intervention in the economy, many companies

are struggling to cope with the growing array of regulations in areas as diverse as the tax code, labor, and the environment.

As noted above, an amendment to Venezuela's consumer protection law was included as part of the 26 decree laws passed on July 31, 2008. This law renamed the consumer protection institute-now INDEPABIS-and gave it broader powers. Since then, INDEPABIS has operated in the absence of implementing regulations which has given its inspectors an extraordinary degree of discretion, resulting in uneven standards and enforcement. INDEPABIS conducted over 15,000 inspections in 2009, and several franchise operations, both domestic and foreign, have been shut down for several days or have faced serious fines due to what some observers see as over-zealous enforcement. Reports indicate that INDEPABIS and industry have agreed to work out more predictable standards and operating procedures.

¶10. (U) Efficient Capital Markets and Portfolio Investment

Capital Markets

Access to the Venezuelan secondary capital market is relatively easy, and foreign firms essentially enjoy treatment equal to that of domestic firms. Foreign companies may issue common and preferred stocks, bonds, and other securities in Venezuelan capital markets. Foreign investors may also buy shares directly in Venezuelan companies or on the Caracas Stock Exchange.

A Capital Markets Law (Gazette No. 36,565 of 1998) gave autonomy to the National Securities Commission and provides regulations for intermediaries, establishes new conditions for public offerings, enhances the transparency of brokerage operations, and makes regulations more flexible for small firms that wish to issue stocks. The Collective Investment Entities Law (Gazette No. 36,027 of 1996) allows for creation of collective investment companies such as mutual funds, collective investment venture capital companies, and collective real estate investment companies.

Credit Markets

Financing is available from a variety of sources, and there is no discrimination against foreign investors seeking access to credit. The credit market is highly regulated, however. The maximum nominal interest rate banks can charge is 33 percent. Banks are required to set aside 44 percent of their portfolio for loans to the housing, agriculture, small business, manufacturing and tourism sectors, in some cases at preferential rates.

The majority of banking sector assets are concentrated in the country's six largest banks, which are generally solid. However, the banking sector as a whole is highly exposed to the public sector through government deposits and bond holdings, some banks have a large percentage of their portfolio in consumption loans, and some banks are pushing the limits of capital adequacy requirements. In November 2009, the GBRV took over or shut down eight banks, ostensibly for violating a number of regulation requirements, but also raising concerns about the levels of government corruption within the banking system. The GRBV now controls approximately 30 percent of the banking sector by assets.

¶11. (U) Competition from State Owned Enterprises

Private enterprises are often at a disadvantage when competing with public enterprises, specifically in terms of accessing foreign exchange at the official rate. For example, non-petroleum public sector imports are eligible for an exchange rate of 2.6 Bs/USD, whereas the majority of private sector imports are eligible only for the 4.3 Bs/USD rate. Public sector companies, in some cases, do not need to go through the GBRV's exchange control board, CADIVI, to request hard currency at the official exchange rate, but CADIVI often delays or refuses the applications of private companies, limiting or denying their access to foreign exchange at one of the two official exchange rates.

State Owned Enterprises (SOEs) are active in almost every sector of the Venezuelan economy, including hydrocarbons, mining, media, telecommunications, tourism, and agribusiness. In the largest and

most important SOEs, the CEO is often a minister in the GBRV. The CEO of PDVSA is also the Minister of Energy and Petroleum; the rest of PDVSA's board members are also appointed by the President. The pattern is similar in other important SOEs, such as the Venezuelan Corporation of Guayana (CVG), a state holding company that includes companies in basic heavy industry, such as electricity generation, steel production, iron ore mining, and aluminum production.

¶12. (U) Corporate Social Responsibility

Many companies in Venezuela have attempted to integrate corporate social responsibility (CSR) into their business models, although it is difficult to measure the general awareness of CSR among consumers. By law, companies bidding on state contracts must earmark five percent of their budget for CSR-related activities. This requirement has raised concerns about corruption, particularly when companies are not vigilant about the organizations receiving the funds and how they administer them. While some foreign and local enterprises have adopted generally accepted corporate social responsibility practices such as the OECD Guidelines for Multinational Enterprises, these principles are not broadly applied.

¶13. (U) Political Violence

Venezuela's political climate is polarized between supporters and opponents of President Chavez and his policies. However, there were no major incidents of political violence that specifically targeted foreign-owned companies or installations in 2009.

¶14. (U) Corruption

Corruption is a very serious problem in Venezuela and appears to be worsening. Venezuela has laws on the books to prevent and prosecute corruption, and accepting a bribe is a criminal act. However, the judicial system has been accused of being politicized and ineffective in applying these laws. Government contracts are vulnerable to corruption because the tender process frequently lacks transparency. The current regime of price and foreign exchange controls has also provided opportunities for corruption.

¶15. (U) Bilateral Investment Agreements

Venezuela has concluded the following bilateral investment agreements as of June 1st, 2009:

Partner

Date of Signature

Date of entry into force

Argentina

16-Nov-93

1-Jul-95

Barbados

15-Jul-94

31-Oct-95

Belarus

6-Dec-07

13-Aug-08

Belgium and Luxembourg

17-Mar-98

29-Apr-04

Brazil

4-Jul-95

Canada

1-Jul-96

28-Jan-98

Chile

2-Apr-93

25-May-95

Costa Rica

17-Mar-97

2-May-01

Cuba

11-Dec-96

15-Apr-04

Czech Republic

27-Apr-95

23-Jul-96

Denmark

28-Nov-94

19-Sep-96

Ecuador

18-Nov-93

1-Feb-95

France

2-Jul-01

30-Apr-04

Germany

14-May-96

16-Oct-98

Indonesia

18-Dec-00

23-Mar-03

Iran, Islamic Republic

11-Mar-05

7-Jun-06

Italy

14-Feb-01

Lithuania

24-Apr-95

1-Aug-96

Netherlands*

22-Oct-91

1-Nov-93

Paraguay

5-Sep-96

14-Nov-97

Peru

12-Jan-96

18-Sep-97

Portugal

17-Jun-94

7-Oct-95

Russian Federation

7-Nov-08

Spain

2-Nov-95

10-Sep-97

Sweden

25-Nov-96

5-Jan-98

Switzerland

18-Nov-93

30-Nov-94

United Kingdom

15-Mar-95

1-Aug-96

Uruguay

20-May-97

18-Jan-02

*Effective November 1, 2008, Venezuela revoked its Bilateral Investment Treaty with the Netherlands. Revocation did not have any immediate consequences for investments made prior to the date of revocation. The BIT remains in force for these investments for a period of 15 years.

¶16. (U) OPIC and Other Investment Insurance Programs

OPIC programs in Venezuela were suspended in 2005 as a result of Venezuela's decertification for failure to cooperate in suppressing international narcotics trafficking. The certification process is an annual event, and in September 2009 the President again determined that Venezuela "failed demonstrably" in living up to its obligations under international counternarcotics agreements and conventions.

However, the President issued a national interest waiver so that the United States could continue to support specific civil society programs and small community development programs in Venezuela. The Export-Import Bank has not provided new financing for projects in Venezuela since formally placing Venezuela "off cover" for new lending in April 2003. Both OPIC and the Ex-Im Bank currently have significant exposure in Venezuela contracted prior to suspending operations.

¶17. (U) Labor

Venezuela's National Institute of Statistics (INE) estimated 6.6 percent unemployment as of December 2009, but this estimate does not include individuals who work in the informal sector or those who are self-employed-both groups collectively constitute more than half of the nation's workforce. Several factors make human resources a challenge for domestic and foreign investors alike: a significant number of skilled and professional Venezuelans have sought employment opportunities abroad due to domestic political and economic uncertainty; government programs that support poorer

Venezuelans have also made it more difficult for companies to attract unskilled labor; and the power of traditional trade unions has diminished as the government has supported the establishment of thousands of "parallel" unions that are closely aligned to government interests. Only 12 to 13 percent of the total workforce is unionized.

In 2009, Venezuela saw a continuing increase in protests and work stoppages by unions in both the public and private sectors. Union protests-in some cases resulting in deaths-disrupted operations at many companies in 2009, including auto assembly plants owned by General Motors, Toyota, and Mitsubishi, and forced the temporary shut-down of various oil drilling operations and oil service companies. Meanwhile, the GBRV has repeatedly delayed negotiations over collective bargaining agreements for workers in the public sector, leaving more than two million public employees without collective contracts, including employees in the oil and gas industry, teachers, and electrical workers.

The Organic Labor Law (Gazette No. 5152 of 1997) places quantitative and total wage cost restrictions on the employment decisions made by foreign investors. Article 27 requires that the number of foreigners hired by an investor not exceed 10 percent of a company's employees, while salaries paid to foreigners may not exceed 20 percent of the total company payroll. Article 28 allows for temporary exceptions to Article 27 and outlines the requirements for hiring technical expertise when equivalent Venezuelan personnel are not available. Article 20 of the law requires that industrial relations managers, personnel managers, captains of ships and airplanes, and foremen be Venezuelan.

¶18. (U) Foreign-Trade Zones/Free Ports

The Free-Trade Zone Law (Gazette No. 34,772 of 1991) provides for free trade zones/free ports. The three existing free trade zones,

created in subsequent Gazette decrees, are located in the Paraguana Peninsula on Venezuela's northwest coast, Atuja in the State of Zulia, and Merida (but only for cultural, scientific, and technological goods). These zones provide exemptions from most import and export duties and offer foreign-owned firms the same investment opportunities as host country firms. The Paraguana and Atuja zones provide additional exemption of local services such as water and electricity. Venezuela has two free ports that also enjoy exemptions from most tariff duties: Margarita Island (Nueva Esparta) and Santa Elena de Uairen in the state of Bolivar.

¶19. (U) Foreign Direct Investment Statistics

U.S. FDI in Venezuela is concentrated largely in the petroleum, manufacturing, and finance sectors. In 2006, according to U.S. Department of Commerce statistics, the stock of U.S. foreign direct investment (FDI) was USD 10.9 billion. More recent FDI statistics are unreliable: the US Department of Commerce reports an increase in FDI since 2006, but information from the local market suggests that there has been very little new FDI in Venezuela in recent years. In 2007, the net inflow of FDI to Venezuela represented roughly 0.4 percent of Venezuela's GDP.
CAULFIELD